

# **Handbook for Measurement of the Non-Observed Economy (Including Underground, Illegal and Informal Activities)**

Michael Colledge

*Organisation for Economic Co-operation and Development*

*2 rue Andre Pascal*

*Paris 75775, France*

## ***Effect of Non-Observed Economy on GDP Estimates***

Good quality statistics are vital for economic policy making and research. The national accounts are the macro economic centre piece. A key aspect of their quality is extent to which they cover all economic production. Complete coverage is a challenging goal because of the wide range of economic activities, some of which are deliberately concealed by businesses to avoid taxes and social charges while others are missed because survey frames exclude small businesses or very new ones. Poor coverage causes problems for both levels and trends of Gross Domestic Product (GDP). Levels of GDP are biased downwards by varying amounts, thus putting international comparisons into question. This can be of great significance when, for example:

- monetary contributions made or received by a country depend on its GDP;
- relative poverty is measured by per capita GDP;
- environmental standards are measured by CO<sub>2</sub> emission per unit of GDP;
- tax burdens are computed as ratios of taxes paid to GDP.

Trend estimates are biased if the missing economic activities are growing at different rates from those that are included. For example, it is often conjectured that, in some transition countries, the underground economy is expanding while the official economy is contracting. For the national accountants themselves, lack of coverage causes imbalances in the internal consistency of the accounts where parts of economic transactions may be measured and other parts are not. For example, household expenditures on underground goods and services may be measured because the purchasers have no reason to hide their purchases, whereas the corresponding incomes are not reported.

## ***GDP Adjustment Methods***

It is not surprising, therefore, that national accountants are concerned about missing economic activities. All OECD Member countries adjust their GDP estimates upwards to capture activities that they believe are omitted from the basic statistics. In compiling GDP, the Italian Statistical Office adds about 15% to the basic data from economic surveys to allow for underground and informal activities. Other OECD countries make similar, though usually much smaller, adjustments. In transition countries, on the other hand, the adjustments can be even larger, for example, around 25% for the Russian Federation.

However, according to many media reports, the adjustments made by national statistical offices are not enough. Reports often suggest that official GDP figures fail to cover much larger parts of the economy than the national accountants believe can be possible. They challenge the credibility of national accounts' estimates. The problem is that many media reports are based on faulty estimation methods. They often fail to define exactly what is to be measured and thus, possibly, missed. This lack of precision regarding the measurement target is epitomized by the wide range of different terms in common use - *hidden economy, shadow economy, parallel economy, subterranean economy, informal economy, cash economy, black market* - to mention just a few. There is no common understanding whether they all mean the same thing, and if not, what relationships they have to one another. Capital flight, tax evasion, smuggling, theft and extortion may all be lumped together as undesirable or illegal activities which are being grossly underestimated by the official figures.

A second problem is that many estimates use very crude assumptions. For example, the so-called *monetary methods* assume that changes in the supply of currency and the (unknown) velocity with which it circulates are entirely attributable to the hidden economy. Another popular model is based on changes in consumption of electricity. Such methods make inadequate use of the wealth of pertinent economic data available and there is no obvious way in which their findings can be combined with others to provide more reliable measures.

This discussion raises questions about what is meant by informal, underground, illegal, unmeasured, unrecorded, untaxed, etc., activities. How do these activities relate to one another? Are they part of or different from the shadow economy, the cash economy, the parallel economy, the subterranean economy, etc? What are the best methods for estimating such activities? How reliable are the current figures? Where do capital flight, tax evasion and the shuttle trade fit in.

### ***Handbook Objectives and Strategy***

The objectives of the *Handbook for Measurement of the Non-Observed Economy* are to provide a common language in which to express these problems and to put measurements of economic production on a firm footing, identifying what kinds of economic activities may be missed by the national accounts, why they are missed and what can be done about it. The *Handbook* is aimed at producers and users of macroeconomic statistics. The primary audience is the staff of national statistical systems involved in the collection of macroeconomic statistics and preparation of the national accounts. In addition, the *Handbook* may prove useful to data users who have reason to be concerned about overall levels of economic production or differentials in trends between the economic activities that are directly measured and those that are indirectly estimated as (part of) the NOE. The *Handbook* may also help researchers and journalists who are confronted with a plethora of measures of the hidden, underground, shadow economy, etc., and who would like to know why they are all different and which can be regarded as the most reliable.

Given the miscellany of possible approaches to measurement of the non-observed economy, the main goal of the *Handbook* is to identify and promote international best practice. Thus, the *Handbook* presents a systematic strategy for achieving exhaustive estimates of GDP that is consistent with international standards, in particular, with the 1993 System of National Accounts, and that reflects a convergence of opinion amongst statisticians and national accounts experts as to what constitutes best practice. The non-observed economy is defined to be those production activities that are liable to be omitted from GDP estimates because they are underground, illegal, informal or by households for their own use, or because of deficiencies in the statistical system. The strategy for dealing with them comprises three stages:

- assess the national accounts and the basic data collection system that feeds accounts and identify the data weaknesses and the priorities for dealing with them;
- supplement and adjust the basic data during the compilation of the national accounts;
- improve the statistical infrastructure and data collection mechanisms to bring them into line with international standards and best practices.

The *Handbook* is being put together by an international of experts team from the OECD, ILO, IMF, Interstate Statistical Committee of the CIS, the Italian statistical office, Statistics Netherlands and Goskomstat Russia. It will be published on the Internet in October, in print form by the end of the year and in Russian and French in the first quarter of 2002.

### **REFERENCES**

Handbook for Measurement of the Non-Observed Economy: [www.oecd.org/std/dnm](http://www.oecd.org/std/dnm)

### **RESUME**

L' article explique les raisons pour lesquelles l' OCDE, avec certaines autres organisations, est en train de développer un manuel sur la mesure de l' économie cachée, c' est à dire, qui vise à l' inclure dans le produit national brut des activités illégales, cachées ou informelles, ou encore exercées par les ménages pour leur propre usage.